TC 97-1
Tax Type: TELECOMMUNICATIONS EXCISE TAX
Issue: Nexus (Taxable Connection With or Event Within State)

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
ADMINISTRATIVE HEARINGS DIVISION
SPRINGFIELD, ILLINOIS

THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS	)	
versus	)	**Docket #**
TAXPAYER	)	**Registration #**)
Taxpayer	)	

RECOMMENDATION FOR DISPOSITION

Appearances:
Assistant Tax Counsel, for the taxpayer.

Synopsis:

This matter comes for hearing following the timely protest by TAXPAYER and TAXPAYER (hereinafter "TAXPAYER" or the "Taxpayer") to three Notices of Tax Liability issued by the Illinois Department of Revenue (the "Department") for the period of January 1, 1986 through August 1988. The taxpayer was audited by the Department and as a result was assessed additional Telecommunications Excise Tax.

At issue is the amount of All Call Travel Card Service (hereinafter "All Call") liabilities that the taxpayer owes to the state. The taxpayer disputes the fact that the State of Illinois has sufficient nexus with All Call to support the imposition of tax. If nexus is found, the taxpayer disagrees with the All Call computation

done by the auditor. In addition, the taxpayer has requested a reasonable cause abatement of penalties.

After the hearing held in this matter, the parties stipulated to certain facts. Included in the stipulations is the fact that a large credit was improperly included in the dollar sample used to create the 2.29% error rate established in the sample used by the auditor. The sample was then projected to form the basis of the non-All Call portion of two of the assessments. If the credit is properly accounted for, the error rate is decreased to 1.91%. The taxpayer agrees to the test sample if the error rate is decreased to 1.91%.

Another stipulation states that the liabilities established did not take into account receipts from customers who were exempt from the tax. If those liabilities are accounted for, one of the assessments is reduced correspondingly.

It is recommended that the Director of the Department reduce the assessments pursuant to the stipulations, and uphold the remainder of the Notices of Tax Liability.

Findings of Fact:

1. The Department's *prima facie* case was established by the admission into evidence of the Department's Group Exhibits numbered I through III, consisting of three Notices of Tax Liability and the corresponding Correction of Returns/Determination of Tax Due for the period of January 1, 1986 through August 1988. (Tr. pp. 9-14)

2. During the audit period, the taxpayer was located in Cedar Rapids, Iowa and in the business of providing long distance telephone service. (Dept. Ex. No. 1; Taxpayer Ex. No. 4)

3. TAXPAYER Company, registration number, was issued Assessment on June 21, 1989, for the period of January 1, 1986 through June 30, 1986, in the amount of $129,553.84, the breakdown of which is: $80,322.00 tax, $6,024.00 penalties and $43,207.84 interest. (Dept. Ex. No. III; Joint Stip. No. 2)

4. TAXPAYER Company, registration number, was issued Assessment on May 31, 1990, for the period of July 1, 1986 through December 31, 1987, in the amount of $843,190.74. The breakdown of the assessment is: $558,365.00 tax, $25,315.00 penalties, and $259,510.75 interest. (Dept. Ex. No. II; Joint Stip. No. 1)

5. TAXPAYER, registration number, was issued Assessment on May 31, 1990, for the assessment period of January 1988 through August 1989, in the amount of $887,404.73 of which $683,471.00 was tax, $48,347.00 was penalties and $155,586.73 was interest. (Dept. Ex. No. I; Joint Stip. No. 1)

6. The taxpayer submitted a payment "under protest" on April 16, 1990, in the amount of $400,000.00, to be directed to accounts and. (Dept. Ex. No. II)

7. Between 1986 and 1987, TAXPAYER reorganized and became TAXPAYER. (Tr. p. 14)

8. Assessment is an extension of Assessment, necessitated by the taxpayer's reorganization and the issuance of a new Illinois account number. (Tr. p. 14)

9. The taxpayer has six billing cycles per month. (Taxpayer Ex. No. 4)

10. The auditor selected a sample from TAXPAYER's January 10, 1988 billing cycle to calculate the error rate for Assessments. (Joint Stip. No. 5; Taxpayer's Ex. No. 4)

11. The taxpayer agreed to use the random sample of 265 customer statements from the billing cycle dated January 10, 1988 for the audit periods. (Tr. p. 12; Dept. Ex. No. IV; Taxpayer's Ex. No. 4)

12. The sample size consisted of 265 units and $8,471.86 dollars for a percentage of error of 7.86%. The percentage of error was then applied to total customer billings for the audit period. The taxpayer felt that the amount of error attributable to All Call, 76% of the 7.86% error rate, accounted for too much of the total percentage of error. The taxpayer and Department decided to separate the All Call portion from the sample and have a separate projection for that portion. (Taxpayer's Ex. No. 4)

13. The dollar amount of the sample for non-All Call revenue totaled $6,987.99. The dollar amount of the errors noted in the sample for non-All Call revenue totaled $160.07. By dividing the total error dollars for non-All Call revenue by the total dollars of the sample for non-All Call revenue, the auditor developed a 2.29% error rate for the non-All Call revenue. (Joint Stip. No. 4)

14. Assessments and were based, in part, on the 2.29% error rate that was calculated and applied to non-All Call revenue. (Joint Stip. No. 3)

15. A large credit was improperly included in the total dollars per sample. If the credit is properly accounted for, the

total dollars per sample increases to $8,396.02 and the error rate decreases to 1.91%. (Joint Stip. No. 4)

16. Therefore, the correct error rate to be applied to non-All Call Travel Card Service is 1.91%. This results in a reduction in Assessmentof $20,130.00 and a reduction in Assessmentof $56,231.00 in tax with a reduction in the corresponding penalties and interest. (Joint Stip. No. 5)

17. The taxpayer is in agreement with the adjustment and random sampling size of the non-All Call portion of the assessments, if the error rate is reduced to 1.91%. (Tr. pp. 42-43)

18. All Call is a stand alone calling card service which enabled the taxpayer's customer to make long distance calls from anywhere in the United States. (Tr. p. 21)

19. In order to engage the All Call system, a customer dials an 800 number, provided through, which directs the call to a taxpayer operator in Cedar Rapids, Iowa. (Tr. p. 21)

20. After the taxpayer operator received the authorization code from the customer, the operator connected the customer with the receiver of the call. (Tr. p. 21)

21. During the time of the audit period, technology had not developed sufficiently to enable the taxpayer to determine the origin of the 800 call. (Tr. p. 21)

22. During the course of the audit, the Department was able to identify the termination point of the calls. (Tr. p. 22)

23. Sixty-eight percent (68%) of the calls in the original sample, done in conjunction with the audit, terminated in Illinois and were billed to customers located in Illinois. (Tr. p. 22)

24. The auditor taxed one-hundred percent of All Call revenues billed to an Illinois mailing address. (Tr. p. 22)

25. The All Call revenues billed to Illinois addresses amounted to about 34% of all of the taxpayer's All Call revenues nationwide for the assessment period. (Tr. p. 22)

26. On December 6, 1986, the Director of Taxes for the taxpayer wrote to the Department requesting a letter ruling regarding the All Call system. The letter stated that the taxpayer was to undergo an audit starting in January. (Taxpayer' Ex. No. 5)

27. TAXPAYER was acquired by CORPORATION in 1990 and is a wholly-owned subsidiary of the CORPORATION Communications Company. All of the operations have been merged with CORPORATION. (Tr. p. 38)

28. Technology now exists to substantiate the origin and termination points of an All Call telephone call. (Tr. p. 27)

29. Assessment was erroneously based, in part, on receipts from customers who were exempt from the telecommunications excise tax and for which exemption certificates were on file with TAXPAYER. (Joint Stip. No. 6)

30. According to the auditor's work papers, a pilot sample of TAXPAYER's billings to Illinois customers was used to determine its tax liability. The auditor noted that TAXPAYER did not tax certain customers that under the Telecommunications Excise Tax Act and 86 Ill. Admin. Code §495.105 were exempt from the tax. Based on the January 10, 1988 billing cycle, receipts from exempt customers totaling $23,773.38 were improperly taxed and Assessment F(M)-15818 must, accordingly, be reduced by $1,200.00 in tax and the corresponding penalty and interest. (Joint Stip. No. 7)

Conclusions of Law:

On examination of the record established, it has been demonstrated by the presentation of testimony or through exhibits or argument that there is evidence sufficient to establish the fact that the Department's *prima facie* case of tax liability should be reduced pursuant to the stipulations between the two parties. In support thereof, the following conclusions are made:

The statute involved is this case is the Telecommunications Excise Tax Act (hereinafter the "Act") which imposes a tax on the act or privilege of originating in this state or receiving in this state interstate telecommunications by a person in this state. The tax is imposed at the rate of 5% of the gross charge for such telecommunications purchased at retail from a retailer by such person. 35 **ILCS** 630/4[1] The Act currently provides the following definitions: (1) "gross charge" is the amount paid for the act or privilege of originating or receiving telecommunications in this State; (2) "amount paid" is the amount charged to the taxpayer's service address in this state; and (3) "Service address" is the location where the services are originated or received and if this location is not defined, it is the location of the taxpayer's primary use of the equipment. 35 **ILCS** 630/2[2]

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[1]. For the taxable year in question, see Ill. Rev. Stat. ch 120, ¶2004.

[2]. For the audit period, the language regarding "gross charge" and "amount paid" was found at Ill. Rev. Stat. ch. 120, ¶2002. The definition of "Service Address" is discussed on page nine of this recommendation.

The taxpayer and the Department stipulated that the error rate should be reduced to 1.91% of the sample done January 10, 1988, which was used for Assessments and. If the percentage is reduced, the taxpayer removes the objection to the sample size. I therefore find that the error rate should be reduced to 1.91% and the sample size as determined by the January 10, 1988, Illinois billing should remain as established by the Department with the approval of the taxpayer.

Therefore, the only remaining issues are in regard to the All Call portion of the audit and are specifically: (1) is there sufficient nexus with the taxpayer to subject the All Call program to telecommunications taxation in Illinois; (2) to what extent are All Call telephone calls billed to an Illinois resident subscriber taxable to the taxpayer under the Act; and, (3) has the taxpayer shown reasonable cause for abatement of penalties as established pursuant to 35 **ILCS** 735/3-8.

ISSUE #1:

With regard to the assertion that Illinois does not have sufficient nexus with the taxpayer's All Call service to impose the telecommunications tax on that service, Goldberg v. Sweet, 488 U.S. 252 (1989), addresses the issue by stating the following:

> We believe that only two States have a nexus substantial enough to tax a consumer's purchase of an interstate telephone call. The first is a State like Illinois which taxes the origination or termination of an interstate telephone call charged to a service address within that State. The second is a State which taxes the origination or termination of an interstate telephone call billed or paid within that State. *id*. at 263-264

The example given by the United States Supreme Court substantiates the Department's imposition of telecommunications excise tax upon this taxpayer's All Call service. I therefore find that the Department had sufficient nexus with the taxpayer's All Call service to impose the tax.

The taxpayer relies on the fact that a refund was granted by the state of Wisconsin to them for tax paid on a portion of long distance services used by the taxpayer's subscribers in Wisconsin, to validate their claim that no taxes are due on their All Call service. The statute imposing the telecommunications excise tax in Wisconsin, during that audit period, imposed a tax on interstate service that "originates from and is charged to a telephone located in this state." The statute specified that the call had to be charged to a telephone within the state. That language was subsequently changed to add the phrase "a subscriber or" before the word telephone. See Wis. Stat. §77.52(2)(a)4 and 5. Section 77.52(2)(a)5 was adopted due to the divestiture of the telephone industry which caused changes in billing procedures. *See* Taxpayer's Ex. No. 1

Not only is the decision of a hearing officer of the Tax Appeals Commission of the state of Wisconsin not binding on me, but in fact the language of the Illinois statute is not the same as the language of the statute in Wisconsin, contrary to what was asserted by the taxpayer. The Illinois statute imposes a tax on the act or privilege of originating or receiving in this state interstate telecommunications by a person in this state purchased by such person at retail from a retailer. The Wisconsin statute, under which the taxpayer was granted a refund, required that the telephone call

originate and be charged to a telephone located in that state. Because of the differences in the statutory language and the lack of precedence, I find the fact that the Wisconsin Tax Commission abated taxes for the taxpayer is not relevant.

ISSUE #2:

In regard to the extent that the All Call service program is taxable in Illinois, the auditor found that any All Call charges billed to an Illinois subscriber were taxable by the Department to the taxpayer for the audit period at issue. "The question of whether something is subject to taxation pursuant to a taxation statute is solely one of law." Arenson v. Department of Revenue, 279 Ill.App.3d 355, 358 (1996), citing Thomas M. Madden & Co. v. Department of Revenue, 272 Ill.App.3d 212 (1995). Arenson goes on to state:

> Taxing statutes are to be strictly construed. Their language is not to be extended or enlarged by implication, beyond its clear import. In cases of doubt, they are construed most strongly against the government and in favor of the taxpayer. (citations omitted.) In strictly construing the provisions of the Act, our primary rule is to ascertain and give effect to the intention of the legislature. (citation omitted) The language of the statute itself is the best indicator of the legislative intent.

The taxpayer argues that a service address is not the same as a billing address in support of the assertion that All Call charges billed to an Illinois subscriber should not be taxable by the Department. They offered the Department's private letter ruling 85-1209, issued December 19, 1985, in support of that assertion.

Private letter rulings are issued by the Department in response to specific inquiries from taxpayers. They obligate the Department

only with respect to the taxpayer making the request. They are not precedent. The letter ruling was not issued to the taxpayer and is therefore not binding in this matter. See 2 Admin. Code ch. I Sec. 2100.110.

In the definition section of the Telecommunications Excise Tax Act, found at 35 **ILCS** 630/2, is the following definition of a service address:

> (n) "Service address" means the location of telecommunications equipment from which the telecommunications services are originated or at which telecommunications services are received by a taxpayer. In the event this may not be a defined location, as in the case of mobile phones, paging systems, maritime systems, air-to-ground systems and the like, service address shall mean the location of a taxpayer's primary use of the telecommunications equipment as defined by telephone number, authorization code, or location in Illinois where bills are sent.

As the taxpayer correctly states in its brief, this definition was added in 1989, becoming effective September 11, 1989. The definition is consistent with the rationale used in Goldberg v. Sweet, *supra*. However, I do not agree with the taxpayer's assertion in the brief, that the location in Illinois where the bills are sent is only applicable to the calls made from a motor vehicle or other mobile location. Rather, I think that the definition is applicable to the circumstances here. The taxpayer bills the owner of the calling card, at his address, for the calls made using the card. I find that the language authorizing the Department to use the location where the bills are sent as the service address is particularly applicable where it is impossible to establish another service address. The analogy of a travel card telephone card to a mobile service type of telephone is evident. The owner purchases the travel

card services because he is mobile and the card enables him to use the taxpayer's services when he is traveling and not at his standard location. I find that a traveling card service, in this respect, is very similar to a mobile telephone, and therefore the portion of the definition stating that the service address is the location in Illinois where bills are sent, to be applicable.

In its attempt to minimize the tax liability with the state of Illinois for the taxable period in question, the taxpayer offered a survey conducted in July, 1995, using CORPORATION customers. However, the survey done by the taxpayer using CORPORATION customers in July 1995, I find is not relevant to establish the taxpayer's All Call pattern for the taxable period in question. Not only is CORPORATION a different entity than the taxpayer, but a different time period was used for the survey. CORPORATION is a nationwide provider of long distance services whereas the taxpayer, at the time of the audit, was a regional provider of long distance services.

The Department found taxable all of the All Call revenues billed to an Illinois mailing address. The taxpayer argues that because it was unable to ascertain the origin of a telephone call when the 800 number was called, the taxpayer should not be responsible for taxation on that call. Taxpayer further argues that the only origin that can be placed is at the taxpayer's Cedar Rapids facility where the 800 call is transmitted for the purpose of dispatching to its final destination. This argument fails because the entire package that the Illinois resident purchased from the taxpayer included the 800 number which was necessary to relay the particular call to the

operator in Cedar Rapids from where the transmission continued to its final destination.

The Correction of Returns/Determination of Tax Due is *prima facie* correct and the burden is on the taxpayer to overcome such presumptions of validity by producing competent evidence to show that the Department's computations were incorrect. American Welding Supply Co. v. Department of Revenue, 106 Ill.App.3d 93 (1982) The taxpayer has not established that the 800 calls did not originate in Illinois. The testimony regarding the survey done by CORPORATION in 1995 was given by the manager of marketing analysis for calling cards for CORPORATION, who had been previously employed as an analyst for direct sales planning and business analysis for CORPORATION. I find his testimony to be self serving, as the taxpayer has become incorporated into the CORPORATION network and CORPORATION will bear the eventual burden of the taxes imposed pursuant to this audit. I find that the taxpayer has failed its burden of overcoming the presumption that the tax assessed by the Department was incorrect.

ISSUE #3:

The taxpayer also requests an abatement of penalties for reasonable cause. For the assessment period herein, the assessment of penalties for Telecommunications Excise Tax were statutorily provided for by the incorporation of provisions of the Retailer's Occupation Tax Act.[3] The taxpayer asserts, as the basis of the request, that the taxpayers were unable to calculate the tax due

[3]. See Ill. Rev. Stat. ch. 120, ¶2009; 35 **ILCS** 630/9

because of the limitations within the taxpayers' billing systems and the technological shortcomings within the industry at that time. There is no provision for abatement of penalties due to the lack of technology to properly calculate the tax due. Rather, the taxpayer should have contacted the legal office and requested a ruling on the proper computation of the tax.

The taxpayer also asserts that the payment of $400,000.00 toward Assessments and evidences the taxpayer's good faith in this matter. I do not agree. A payment of only one-third of the liability is not evidence of good faith.

It was only when the taxpayer became aware of the pending audit by the Department did it contact the legal office of the Department for a determination of what portion of the All Call travel service was taxable by the state. Due to departmental rules,[4] the legal office will not issue a private letter ruling if the taxpayer is involved in an audit. Therefore, the taxpayer's argument based upon the lack of the Department's response to their letter has no merit.

I find that the taxpayer was not diligent in the exercise of ordinary business care and prudence regarding its tax liability to this state.[5] The taxpayer was presumably aware that they owed some tax to the state, but were unsure of the amount. They could have

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[4]. See 2 Admin. Code ch. I Sec. 1200.100(a)(3)(C)

[5]. The Legislature enacted the Uniform Penalty and Interest Act, found at 35 **ILCS** 735 *et seq.*, effective January 1, 1994, which is applicable to all taxes administered by the Department. In conjunction with the Act, the Department has promulgated rules to interpret reasonable cause for an abatement of penalties. See 86 Admin. Code ch. I, Sec. 700.400 The rules require that the taxpayer make a good faith effort to determine his proper tax liability and file and pay the proper liability in a timely manner.

contacted the legal division of the Department and received a letter ruling prior to the contact by the audit section of the Department. Instead, they chose to wait until just before the audit commenced to contact the legal office to ascertain the proper amount of taxability of the All Call services. Therefore, I find that an abatement of the penalties imposed because the taxpayer did not timely file and pay taxes is inappropriate.

For the foregoing reasons, I recommend that the error rate for the non-All Call portions of Assessments and be reduced to 1.91%, resulting in a reduction of Assessment of $20,130.00 tax, with a corresponding reduction of interest and penalties, and a reduction of Assessment F-16066 of $56,231.00 in tax with the corresponding reduction of interest and penalties. For the All Call portion of the assessments, I find that the determination that the tax imposed on telephone calls billed to an Illinois mailing address is correct.

In addition, Assessment was based, in part, on receipts from customers who were exempt from the telecommunications excise tax and for which exemption certificates were on file with the taxpayer. The receipts from exempt customers, which total $23,773.38, were improperly taxed. Assessment must, accordingly, be reduced by $1,200.00 in tax and the corresponding penalty and interest.

Respectfully Submitted,

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Barbara S. Rowe
Administrative Law Judge
March 25, 1997